

**BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN**

**Allocation on the Commission's Own Motion
Regarding Ratemaking Approaches that Promote
Conservation & Efficiency Programs by Removing
Disincentives That May Exist Under Current
Ratemaking Policies**

Docket No. 05-UI-114

**COMMENTS OF THE
INDUSTRIAL CUSTOMER GROUPS
MIDWEST FOOD PROCESSORS ASSOCIATION,
WISCONSIN INDUSTRIAL ENERGY GROUP, and
WISCONSIN PAPER COUNCIL**

I. INTRODUCTION AND INTERVENOR INTEREST.

The Midwest Food Processors Association ("MWFPA"), Wisconsin Industrial Energy Group, Inc. ("WIEG"), and the Wisconsin Paper Council ("WPC") (together, the "Industrial Customer Groups" or "ICG"), appreciate the opportunity to provide comments in the Public Service Commission of Wisconsin's (the "Commission" or "PSCW") Investigation on its Own Motion Regarding the Innovative Utility Ratemaking Approaches That Promote Conservation and Efficiency Programs by Removing Disincentives That May Exist Under Current Ratemaking Policies (the "Investigation").

MWFPA represents a variety of large food processors in Illinois, Minnesota and Wisconsin and over 250 businesses that serve the industry. Its members have over 80 facilities in the Midwest with 35 of them in Wisconsin providing an estimated direct economic impact of over three billion dollars to Wisconsin's economy. The food processing industry uses a large amount of energy for sanitation and food preparation purposes.

WIEG represents over 30 large companies with operations in Wisconsin, which together employ approximately 50,000 people. WIEG members represent many of the state's largest energy consumers including paper, malting, automobile, food processing, chemical, metal casting, and fabricating companies.

WPC is the trade association representing the pulp, paper and allied industries. WPC's membership is comprised of 21 Regular Members, which are manufacturers of pulp, paper and paperboard products, and more than 100 Converter and Associate Members, which are suppliers of goods and services to the pulp and paper industries. Wisconsin is the nation's leading paper manufacturing state. WPC was formed in 1950.

II. BACKGROUND.

The Commission has opened an investigation to consider innovative utility ratemaking approaches that promote conservation and energy efficiency programs. As part of this investigation, the Commission wishes to examine existing ratemaking policies that may discourage utilities from implementing their own programs or supporting statewide programs, and potentially identify options that may instead encourage utilities to promote energy efficiency programs. The Commission is seeking comments to questions to help further this investigation. Once comments are received from various intervening parties, Commission staff will develop a document identifying alternative options on the different subject areas addressed in the survey. This document will be submitted to stakeholders for comment after which Commission staff will develop a draft report, which could potentially include options that are considered favorable and/or that need further investigation. This report will be finalized after soliciting comments from stakeholders.

The ICG welcomes the opportunity to respond to the Commission’s survey. This Investigation has significant policy implications with respect to promoting conservation and energy efficiency. Therefore, it is critical that the Commission thoroughly investigate all available options for encouraging more energy efficiency, to ensure that any option it adopts is cost effective and does not unnecessarily harm utility customers. With escalating utility costs due to environmental compliance initiatives, increasing fuel costs, and the growth of utility infrastructure through upgrades and additions, Wisconsin cannot afford to embrace any initiative that will create unnecessary costs and rate volatility.

III. OVERVIEW OF ICG POSITION ON REMOVING DISINCENTIVES AND PROMOTING ENERGY EFFICIENCY.

Gauging from the questions included in the Commission’s survey, the Commission appears most interested in investigating decoupling as a way to remove—as some have characterized—disincentives to the promotion of energy efficiency programs by utilities. The Commission also appears to be seeking decoupling alternatives that would encourage utilities to more aggressively pursue energy efficiency programs as a supply side resource.

The ICG believes that the premise of the Commission’s Investigation—*i.e.*, that incentives are necessary to encourage Wisconsin’s utilities to broaden their energy efficiency efforts—is faulty, for at least two reasons. First, there is no “problem” with Wisconsin’s current energy efficiency programs, due in large part to the success of current law. Second, to the extent that the Commission wishes to encourage still more energy efficiency, it can do so within the existing statutory and regulatory framework. This approach avoids increasing the complexity of regulations which ICG believes is

likely to increase the risk of unintended consequences without a corresponding benefit—a consequence that all too frequently results from the introduction of new and untested regulations. Thus, while ICG addresses most of the Commission’s survey questions, it believes that the current statutory and regulatory framework governing energy efficiency programs is sufficiently robust that there is little need for the sweeping modifications that the Commission is now considering. In short, there appears to be little evidence that utilities need incentives to promote energy efficiency.

A. UTILITIES DO NOT NEED AN INCENTIVE TO PROMOTE ENERGY EFFICIENCY PROGRAMS BECAUSE THEY ALREADY HAVE ENERGY-EFFICIENCY OBLIGATIONS.

Both Wisconsin Statutes and the Commission’s own authority already provide sufficient support for the state’s energy efficiency needs. First, Wisconsin 2005 Act 141 (“Act 141”) requires that 1.2 percent of a utility’s operating revenues be spent on energy efficiency initiatives. Wis. Stat. § 196.374(3)(b)2. Should the Commission deem it necessary following review of several matters, including the likelihood of energy efficiency gains and economic impacts associated with attaining potential gains, it “may require each energy utility to spend [more than 1.2 percent] of its annual operating revenues to fund [energy efficiency] programs.” Wis. Stat. § 196.374(3)(b)2.a.

Second, the Commission has used its authority to condition its approval of new generating facilities on the applicant-utility achieving identifiable energy efficiency goals. Perhaps the most recent example is found in WE Energies’ Power the Future application. In issuing a Certificate of Public Convenience and Necessity, the Commission ordered WE Energies to capture 55 megawatts (“MW”) of cost-effective energy conservation within four years. *See* Order, APPLICATION OF WISCONSIN ELECTRIC

POWER COMPANY; WISCONSIN ENERGY CORPORATION; AND W.E. POWER, LLC; FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR CONSTRUCTION OF THREE LARGE ELECTRIC GENERATION FACILITIES, THE ELM ROAD GENERATING STATION, AND ASSOCIATED HIGH VOLTAGE TRANSMISSION INTERCONNECTION FACILITIES TO BE LOCATED IN MILWAUKEE AND RACINE COUNTIES, Docket No. 05-CE-130, November 10, 2003, Order Point 19.

Therefore, because increased energy efficiency is codified and directs state policy, utilities are now obligated to pursue energy efficiency through either the statewide Focus on Energy program or by developing their own programs. Wis. Stat. § 196.374(2)(a) and (b). Utilities do not need incentives to promote, offer and maintain successful energy efficiency programs; they already are required by law to do so.

B. FOCUS ON ENERGY, AN INDEPENDENTLY RUN PROGRAM, IS THE MOST APPROPRIATE FOUNDATION FOR PROMOTING ENERGY EFFICIENCY IN THE STATE—AND RATHER THAN DECOUPLING A UTILITY’S REVENUE FROM ITS SALES, THE COMMISSION SHOULD USE THE EXISTING FOUNDATION FOR ENERGY EFFICIENCY TO DECOUPLE PRODUCT SALES FROM THE PROMOTION OF CONSERVATION.

At present, Wisconsin has a statewide energy efficiency program that is administered by the Commission. Wisconsin is recognized nationally as progressive in promoting energy efficiency through an independent entity.¹ Using an entity other than utilities supports the basic premise that utilities are better occupied focusing on their core business and mission. While utilities can effectively focus on their core business in the sale and delivery of natural gas and electricity, an independently-run program administered under the Commission’s purview can concentrate its efforts with its core

¹ Electric Consumers Resource Council’s (ELCON’s) Policy Document on Decoupling.

business—energy efficiency. No conflicting objectives are to be met by either entity. No additional complexities need to be imposed to remove any perceived or potential disincentives. No incentives are necessary to coax utilities to implement initiatives—initiatives that would conflict with their interest in maximizing shareholder profits.

Instead, Focus on Energy or similar programs by other third-party, non-utility providers need to be expanded such that this statewide initiative is the clear, highly visible vehicle for promoting energy efficiency, including the implementation of utility-ordered programs. There are several advantages to using Focus on Energy as the umbrella program for energy efficiency including, but not limited to:

- Greater brand equity and less customer confusion regarding which is the “go-to” organization for energy efficiency.
- More effectiveness in advancing the ongoing goal of market transformation.
- No additional mechanisms required to address disincentives for energy utilities.
- Eliminate duplication of effort and reduce administration costs.

In this manner, the independent statewide program has the ability to implement its core function of promoting energy efficiency more effectively, rather than trying to introduce mechanisms at the utility level where there is a high potential for adverse and unintended consequences for customers. At the same time, the utilities can concentrate their efforts on their core business of producing/acquiring, selling and delivering electricity and natural gas. Also, no activity should distract utilities from focusing on improving efficiency in their core operations.

Since the Commission administers the Focus on Energy program, this direct regulatory oversight will likely also assure that the programs being implemented are cost effective.

C. SINCE UTILITIES SUBMIT RATE APPLICATIONS ON A REGULAR BASIS AND ALSO OBTAIN APPROVALS FOR HIGHER-THAN-INDUSTRY-AVERAGE RATES OF RETURN, THERE IS LIMITED RISK AND NO DISTORTIONS THAT MIGHT RESULT IF THERE WERE LONG LAGS BETWEEN RATE CASES.

One of the benefits of this Commission's support for utilities to file biennial rate plans is the utilities' opportunity to regularly and frequently realign their sales forecasts and revenues. At least once every two years Wisconsin utilities update their sales forecast data. As a consequence, they should be able to encourage energy efficiency with little concern or uncertainty as to how energy efficiency will reduce their sales.

Utilities' risks are further reduced by the higher-than-industry-average returns on equity that this Commission has consistently authorized over the past several years. For the most recent year for which the information is available—September 2006 through August 2007—of the reported 57 state public utility commission decisions for which authorized returns were addressed, all but five (46) had returns lower than those returns authorized by this Commission. See "Annual ROE Survey, Capitalizing on Grid Concerns", PUBLIC UTILITIES FORTNIGHTLY, November 2007, pp. 43-46. Wisconsin's high authorized rates of return will compensate the utilities for any perceived risk that flows from sales uncertainties.

Overall, the current ratemaking practice maintains regulatory oversight to protect customers while providing mechanisms whereby utilities can regularly update their sales forecast and request revised cost recovery to protect their bottom line and mitigate risk

for their investors. Consequently, in Wisconsin practice there is little room for distortions because of the frequent rate case applications.

D. BY ALIGNING FIXED COSTS WITH DEMAND/CUSTOMER CHARGES AND VARIABLE COSTS WITH ENERGY CHARGES, UTILITIES CAN ELIMINATE THE RISK OF REDUCED SALES AND SEND MORE APPROPRIATE, EFFECTIVE PRICING SIGNALS TO CUSTOMERS.

Using the Straight Fixed Variable (SFV) method aligns fixed costs with demand/customer charges and variable costs with energy charges. The SFV method is recognized as an alternative to decoupling.² States such as Georgia and Oklahoma have adopted this method.³

Since fixed costs do not vary with kilowatt-hour (KWh) consumption, they appropriately belong in the demand/customer charges. Similarly, since fuel and variable operations and maintenance costs vary with electricity consumption, it is appropriate to reflect such costs in energy charges. With such rate structures, the lost margin risk, due to lower consumption, is effectively addressed and system efficiencies associated with high load factor customers are recognized and positively reinforced.

For rates applicable to industrials, the three-part rate design of customer, demand and energy charges is already prevalent. Utilities that utilize the equivalent peaker method of cost classification, or other approaches that result in assigning fixed costs to the energy cost component, have the ability to make this change, thereby eliminating the lost margin risk due to lower consumption. In addition, since industrials in general are on time-differentiated rates, the rate objective of economic efficiency is not compromised.

² (National Action Plan, U.S. EPA, November 2007).

³ “Regulatory Issues in Rate Design, Incentives and Energy Efficiency”, David Dismukes, February 2007.

E. REVENUE DECOUPLING MECHANISMS DO NOT PROMOTE ENERGY EFFICIENCY AND, IRONICALLY, SEND MISLEADING PRICE SIGNALS TO CUSTOMERS.

Decoupling mechanisms do not create an economic incentive to promote greater energy efficiency or load reduction. They establish, at best, utility indifference to these objectives: with the utility guaranteed revenues without regard to decreased sales, they would not care whether sales decrease. Indeed, decoupling does nothing to address a utility's interest in growing its rate base.⁴ On the other hand, decoupling undermines a customer's efficiency efforts and muddles price signals: a customer's conservation efforts are rewarded with higher future rates, while excessive consumption paradoxically produces bill credits. This is because lower sales result in spreading the same amount of costs over fewer consumption billing units, and vice versa. *See* Discussion in Section IV. B below for an example. Thus, customers are essentially penalized for their energy efficiency achievements. At a time when more aggressive promotion of energy efficiency is needed, such penalization is counter productive.

F. TO THE EXTENT THAT UTILITIES EXPERIENCE LOWER SALES IN THEIR RETAIL BASE, THEY HAVE THE OPPORTUNITY TO SELL THE "SAVED" MEGAWATT-HOURS (MWHs) INTO THE MISO MARKET.

Since most Wisconsin utilities are participants in the Midwest ISO, they are not limited in the opportunity to sell their excess generation. Since generation offers include start-up and no-load costs, utilities are able to recover such costs through their offer.⁵

⁴ *See, e.g.*, Responses of the Energy Center of Wisconsin to the Questions Set Forth in the Commission Staff's June 3, 2008 Letter, Docket No. 05-UI-2008, pp. 1-8 (wherein the Energy Center of Wisconsin explains why it believes that lost revenue adjustment mechanisms are not answers for the possibility that rate base could diminish as energy efficiency programs grow in size).

⁵ *See* Module C of MISO's Open Access Transmission Tariff (OATT).

In addition, unlike PJM Interconnection, where the market design includes an energy market and a capacity market, MISO's market is designed to be an energy-only market.⁶ The theory behind an energy-only market is that the energy prices signal need for capacity. Since pricing is market based (and so may not be cost based), it is important to note that (a) the infra-marginal revenues provide recovery of fixed costs related to investment in generation assets; and (b) the generation offers most likely include an opportunity cost component. While the infra-marginal revenues are netted against costs, the generation offers are treated as costs and therefore no further netting occurs. Therefore, one would expect that the opportunity cost component provides recovery of the lost margin effect due to lower native load consumption.

G. REVENUE DECOUPLING AND PERFORMANCE INCENTIVE MECHANISMS ADD COMPLEXITY AND OFFER LITTLE CERTAINTY THAT THEY ACTUALLY COMPENSATE UTILITIES FOR ENERGY EFFICIENCY.

To measure the success of a performance incentive, it is critical that our common goal—lower energy consumption—can be tied directly to energy efficiency efforts. The ICG has considerable doubts that such a cause and effect can be demonstrated. Since lower energy consumption may be the result of any one or more of myriad factors including, but not limited to, the weather and economic conditions, it is challenging—if not impossible—to specifically isolate energy efficiency, in contrast to other factors, as the cause of reduced energy consumption. Consequently, any form of decoupling mechanism is likely to overcompensate a utility for its energy efficiency efforts, as reductions in energy consumption will almost certainly result from a number of unrelated factors. As a consequence, a simple methodology to true-up the energy efficiencies will

⁶ See MISO filings to FERC on resource adequacy ER08-394.

be neither practical nor prudent. And the more complicated the methodology—the more one works to fully identify all factors affecting energy consumption reductions—the greater the administrative burden.

Further, cost of service issues are complicated enough; adding another layer of complexity will only divert ratemakers' focus from assuring that cost allocations and rate designs produce appropriate signals. We should all agree that rates based on costs are necessary to avoid a misallocation of resources and to provide appropriate pricing signals. Since decoupling involves an artificial true-up mechanism that departs from accepted and proven cost of service ratemaking principles, it will necessarily result in unjust and unreasonable rates, as discussed in more detail in Section IV below.

Finally, it is widely accepted that decoupling by itself does not promote energy efficiency. Rather, it serves to remove a perceived disincentive. Proponents of decoupling claim that performance incentives are needed in addition to decoupling in order to promote energy efficiency. Aside from the fact that the effects of decoupling cannot be easily discernible, an additional mechanism is needed to promote energy efficiency, thereby adding yet another layer of complexity. This would further increase the administrative burden of ensuring that performance incentives are sound. Similar to the observations made above about decoupling, the ICG also is skeptical that energy efficiency results could be directly tied to performance incentive initiatives.

Determining that the utilities' efforts were directly responsible for increasing energy efficiency is more complicated especially in Wisconsin since there is a statewide energy efficiency program. How could it be ensured that spillover effects, due to the Focus on Energy programs, do not drive the actions undertaken by customers?

H. UTILITY PROFIT MAXIMIZING BEHAVIOR IS PRIMARILY DRIVEN BY SIGNALS FROM FINANCIAL INSTITUTIONS. AS SUCH, EITHER PERFORMANCE INCENTIVES WILL NOT WORK OR WILL NOT BE REQUIRED.

Utilities traditionally profit by earning a return on their physical plant. Signals from financial institutions help determine the level of risk that needs to be reflected in the return on assets and submitted to the Commission for consideration. To the extent that financial institutions are inclined to favor an investment in a physical asset more than an investment that is intangible (*i.e.*, energy efficiency), the utility will still continue to build more assets. Thus, as the proportion of energy efficiency initiatives and, therefore, intangible assets become larger, the proportion of physical generation assets will become smaller, which likely will not be viewed favorably by the investment community.

On the other hand, if financial institutions conclude that today's concerns over climate change demand that utilities promote energy efficiency programs, then the Commission should not be providing performance incentives because utilities will invest in energy efficiency programs if Wall Street expects them to do so. In short, signals from Wall Street are much more likely to drive utility behavior than the Commission.

In either situation, imposing performance incentives mechanisms will be unnecessary.

IV. THE ICG OPPOSES REVENUE DECOUPLING AND PERFORMANCE INCENTIVES.

As discussed in the earlier sections, there are more effective ways to address energy conservation promotion than adding mechanisms that pose a high potential to harm customers. The ICG's comments are intended to provide the context within which we view the survey questions and the larger issue of energy efficiency promotion. It

certainly appears that the Commission assumes that removing a disincentive is necessary, and that it is primarily considering decoupling as the mechanism to remove the disincentive. Further, the Commission also hints that a performance incentive is needed in addition to decoupling in order to promote energy efficiency. The Commission explains in its investigation that:

... there is a disincentive for gas and electric utilities to aggressively pursue cost effective gas and electric energy efficiency programs because doing so results in an adverse impact to shareholders due to lost revenues. Eliminating this disincentive could make the utility indifferent as to whether it implements such energy efficiency programs or constructs new facilities. Decoupling, one such tool to accomplish this, would make the utility whole for lost revenues resulting from these programs. Another tool, and one that could be used in tandem with decoupling, is providing some type of a performance incentive.

NOTICE OF INVESTIGATION.

While one objective of energy efficiency programs is to reduce electricity or natural gas consumption in a cost-effective manner, reducing consumption also reduces utility revenues. Under traditional rate designs that recover fixed costs through volumetric charges, lower revenues often lead to under-recovery of a utility's fixed costs. This, in turn, can lead to lower net operating margins and profits and what is termed the "*lost margin*" effect. Proponents of decoupling argue that by separating the link between sales and revenue, this mechanism is successful in removing the disincentive for utilities to pursue energy efficiency initiatives.

Given the ICG's position identified in Section III, the Commission will not be surprised to learn that ICG members oppose revenue decoupling mechanisms. Its opposition is well-grounded, as explained here. And while ICG is not opposed to promoting energy efficiency, it believes that there are more effective ways to do so than

by implementing decoupling and performance mechanisms as described in Section III and for the reasons that follow:

A. DECOUPLING SALES FROM REVENUE AS A TOOL TO MAKE UTILITIES INDIFFERENT TO ENERGY EFFICIENCY INITIATIVES TRANSFERS THE RISK FROM THE UTILITY TO CUSTOMERS.

While traditional cost of service ratemaking provides utilities with the opportunity to earn a fair rate of return, revenue decoupling is a significant departure from such principles by guarantying actual earnings at the level of authorized earnings. Under revenue decoupling, a utility becomes indifferent not only to the impact of lower consumption due to energy efficiency but, depending on how it is designed, the utility also is indifferent to other factors that can result in the lower consumption such as weather or changing economic conditions. Past experience has indicated that customers assume the risk of all such factors while utilities protect shareholders by continuing to earn their authorized rate of return.⁷

In Maine, the public utility commission adopted a three-year trial revenue per customer decoupling mechanism for Central Maine Power (“CMP”). Shortly after implementation, Maine experienced a recession, which resulted in lower sales,⁸ which caused substantial deferrals that CMP later was entitled to recover. While the majority of the \$52 million deferral resulted from the economic recession, CMP’s decoupling mechanism shielded it against the impact of recession. That risk was unjustly passed to its customers.

⁷ Presentation at Harvard Electricity Policy Group, 37th Plenary Session, San Diego, CA

⁸ Maine PUC report on Utility Incentive Mechanisms for the Promotion of Energy Efficiency & System Reliability”, February 1, 2004, pp.28-29

Thus, while revenue decoupling is successful in protecting the utility, it may simply transfer what historically had been a utility risk to the utility's customers, without a corresponding shift in benefits.

B. BASIC DECOUPLING MECHANISMS INCREASES RATE VOLATILITY AND UNCERTAINTY.

ELCON's policy brief on revenue decoupling provides an example of how basic decoupling works on an overall and per customer basis. Table A is an example of how true-ups are conducted on an annual basis.⁹ The base case includes the baseline determination of a utility's revenue that may include the expected impacts of an energy efficiency program. In this example, the baseline is held constant for a two-year period. In the first year, actual sales are less than the baseline by 1% resulting in a revenue shortfall of \$45 million. The revenue decoupling mechanism is applied in the second year by increasing the customer rate upwards to ensure that the allowed returns are obtained. In the second year, the actual sales end up being 1% higher above the baseline and results in the utility over-collecting by \$90 million. This example demonstrates the potential year-to-year volatility of the decoupling mechanism.

In response to increased rate volatility caused by decoupling in both Maine and Washington, both states abandoned its use. The Washington Utilities and Transportation Commission (the "UTC") approved the adoption of decoupling for Puget Power in October 1991, but by September 1995 had cancelled its use after having concluded that the mechanism did not provide Puget Power with an incentive to manage power costs or

⁹ For more details, see ELCON's "Revenue Decoupling: A Policy Brief of the Electricity Consumers Resource Council, January 2007, available at <http://www.elcon.org/Documents/Publications/3-1RevenueDecoupling.PDF> (the "ELCON Policy Brief").

conservation and other resource acquisitions at lowest costs.¹⁰ (With respect to decoupling treatment in Maine, please *see* footnote no. 8, above.)

Similarly, in the 1990s, the New York Public Service Commission terminated use of a revenue decoupling mechanism for Consolidated Edison because of its detrimental effects which increased rate instability and rate uncertainty.¹¹

SPACE INTENTIONALLY LEFT BLANK

¹⁰ *See*, Washington Utilities and Transportation Commission, Third Supplemental Order, September 21, 1995, Docket No. UE-950618.

¹¹ April 2007, PUBLIC UTILITIES FORTNIGHTLY.

TABLE A¹²

The Mechanics of Revenue Decoupling
An Illustrated Example of An Annualized RD Mechanism¹

Base Year Assumptions		
	Year One	Year Two
Utility's Operating Costs (A)	\$4 billion	\$4 billion
Utility's Rate Base (B)	\$5 billion	\$5 billion
Authorized Return to Equity Owners (ROE)	10%	10%
Authorized Earnings to Equity Owners (C)..... (10% of \$5 billion)	\$500 million	\$500 million
Utility's Authorized Revenue	\$4.5 billion	\$4.5 billion
(A + C)		
RD Balance Account (D).....	0	\$45 million
Baseline Sales (E).....	45,000 GWh	45,000 GWh
Base Rate per KWh	\$0.10	\$0.10
(A + C)/E		
Effective Rate per KWh (F)	\$0.10	\$0.101
(A + C + D)/E		
Actual Sales Year		
Actual Sales (G)	44,550 GWh	45,450 GWh
(1% diviation from baseline forecast)	1% Below Baseline	1% Above Baseline
Actual Revenues Collected (H)	\$4,455 million	\$4,590 million
(F × G)		
Unadjusted Earnings to Equity Owners (I)	\$455 million	\$590 million
(H minus A)		
Reported ('Authorized') Earnings (C).....	\$500 million	\$500 million
Actual ROE	9.1%	11.8%
(I/B)	Reduction of 90 basis points	Increase of 180 basis points
Reported ('Authorized') ROE	10%	10%
End-of-Year Balance Account (D)	\$45 million	(\$90 million)
(A + C) minus H		

¹ This is a simplified example of revenue decoupling that assumes no variable T&D costs or change in the number of customers. Also, tax implications and accounting for price elasticity are ignored.

C. NORMALIZING FOR OTHER FACTORS TO ISOLATE IMPACTS OF ENERGY EFFICIENCY LEADS TO COMPLICATIONS IN ADMINISTERING REVENUE DECOUPLING.

Since the objective of decoupling is to make a utility indifferent to energy efficiency initiatives, it is reasonable to expect that, in order to guarantee a utility's actual

¹² ELCON Policy Brief.

earnings at the level of authorized earnings, the energy reduction must be directly attributable to energy conservation. In order to isolate the impacts of energy efficiency from other factors such as weather, economy, retail price, number of customers etc., sophisticated and complicated modeling needs to be conducted. It quickly becomes apparent that although such modeling can help isolate conservation effects, it is likely to lead to a very contentious process with disagreements likely, regarding a statistical model for baseline usage.¹³

D. SINCE DECOUPLING RESULTS IN A REVENUE GUARANTEE FOR UTILITIES AND ESSENTIALLY DEPARTS FROM COST OF SERVICE RATEMAKING, IT IS HARMFUL TO CUSTOMERS AND THE ENVIRONMENT.

Cost-based rates are essential to properly pricing energy, and to avoiding a misallocation of resources. However, decoupling, by definition, provides utilities a revenue guarantee without regard to the cost to serve customers.

As the American Forest & Paper Association (“AF&PA”) states,

Paying uneconomic “rents” to utility shareholders to prevent them from taking actions harmful to society (i.e., discouraging energy efficiency) is itself harmful to society because it arbitrarily increases the cost of electricity relative to other fuel choices. Further it allows the monopolist to extract economically unjustified “rents” from the rest of the society based on control of essential infrastructure. This is universally recognized as creating economic inefficiency. It was precisely this societal harm that regulation of public utilities was intended to protect against.¹⁴

¹³ An Overview of Revenue Decoupling Mechanisms, Dan Hansen, Christensen Associates & Consulting, April 2008.

¹⁴ Paper of Decoupling by the American Forestry & Paper Association, May 2008.

E. DECOUPLING UNDERMINES CUSTOMER EFFICIENCY EFFORTS AND MUDDLES PRICE SIGNALS TO CONSUMERS.¹⁵

It is well acknowledged that decoupling mechanisms do not create an economic incentive to promote greater energy efficiency or load reduction. They establish, at best, utility indifference to these objectives. At the same time, they also undermine customer efficiency efforts and muddle price signals to consumers. For example, conservation efforts are rewarded with higher future rates, while excessive consumption paradoxically produces bill credits. This also implies that customers are essentially either penalized for becoming energy efficient or rewarded for “back-sliding.” At a time when Wisconsin is contemplating more aggressive promotion of energy efficiency, this would undoubtedly be an inappropriate and misleading signal to send to customers.

F. DECOUPLING HAS THE POTENTIAL TO DISTRACT UTILITIES FROM EFFECTIVELY IMPLEMENTING THEIR CORE BUSINESS.

Since decoupling guarantees returns by making the utility indifferent to the risk of changes in consumption, it has also been identified as eliminating the incentive to: (a) provide high quality customer service, (b) promote economic development and (c) provide and maintain reliable service.

The main function of a regulated utility is to efficiently generate/acquire, sell and deliver energy to customers. Under traditional ratemaking principles, the utility has the opportunity to earn a fair rate of return in exchange for these services. By instead guarantying returns, not only is it counter productive and conflicting to “unsell” its primary product, it also promotes mediocrity and indifference to the utility’s core

¹⁵ See ELCON Policy Brief.

business. The guaranty eliminates the utility's incentive to provide high quality customer service.¹⁶

Decoupling also reduces a utility's financial incentive to support economic development. Once again, by providing a guaranteed authorized rate of return, there is no incentive to promote economic development and attract new commercial and industrial businesses. Eliminating incentives for utilities to maintain or expand load on their systems would undermine the State's economic development initiatives.¹⁷

As ELCON explains:

For all practical purposes, RD mechanisms put utility management on autopilot and this will only further encourage them to ignore their core business, the value of economic development in their franchise area, and the broader needs of utility's customers. These objectives are at least as important as any attempt to only eliminate a disincentive to energy efficiency.

Under standard ratemaking practices, decreases in sales caused by poor or unreliable service would reduce the utility's bottom line. However, under decoupling, since the returns are guaranteed, there is meager to non-existent incentive to continue to maintain reliable service.

Base rates are typically fixed and based on an allowed rate of return under traditional regulation. Between rate cases, actual returns can vary from those authorized. This regulatory lag provides important incentives since it is the utility's responsibility to manage risk associated with sales (revenue) as well as to find opportunities for efficiency

¹⁶ An Overview of Revenue Decoupling Mechanisms, Dan Hansen, Christensen Associates, April 2008

¹⁷ While implementing revenue decoupling using the revenue per customer method could help in eliminating the problem associating with basic decoupling, this method provides utilities with an incentive to game usage (or revenue) per customer value. Also, changes in revenues may not be closely related to changes in costs (An Overview of Decoupling Mechanisms, Dan Hansen, April 2008)

(i.e., cost). Revenue decoupling substantially reduces—if not eliminates—the need to manage sales risk between rate cases.

Normal business risks such as regular business and economic cycles, weather, customer satisfaction, poor or unreliable service must all therefore remain with the utility. Eliminating an incentive to earn a fair rate of return without the responsibility of risk associated with such factors will result in loss of focus on the utility’s core business – with detrimental results for captive customers.

V. RESPONSES TO SURVEY QUESTIONS.

1. Do the current rate structures of the electric and gas utilities in Wisconsin contain a net lost revenue and profit that is significant enough to discourage these utilities from developing and spending additional money on energy efficiency programs?

In Wisconsin (except for Wisconsin Power & Light’s Shared Savings program), energy efficiency programs—whether statewide (Focus on Energy) or utility ordered (WPSC, We Energies)—are mandated and not voluntary. Therefore, it is irrelevant whether utilities are discouraged from developing energy efficiency program or investing additional money in them. Utilities are legally obligated to comply with state statutes and administrative code.

In addition, over the years, utilities have obtained rate case application approvals with returns higher than their industry average¹⁸. Such returns are meant to cover any

¹⁸ For the most recent year for which the information is available—September 2006 through August 2007—of the reported 57 state public utility commission decisions for which authorized returns were addressed in those decision, all but five (46) had returns lower than those returns authorized by this Commission. See “Annual ROE Survey, Capitalizing on Grid Concerns,” PUBLIC UTILITIES FORTNIGHTLY, November 2007, pp. 43-46.

level of assumed consumption risk that could be attributable to exogenous factors such as weather and economic conditions.

Finally, to the extent that rate structures have fixed costs that are not being recovered through volumetric (*i.e.*, related to KWh) charges, as is appropriate, the risk factor associated with lower consumption will be greatly mitigated or even eliminated.

For example, in general, larger customers generally have three-part electric rate designs comprised of customer, demand, and energy charges. If the cost of providing service is appropriately distributed to the individual charges in a three-part rate design, it will provide the utility with revenue to recover the fixed cost of providing service irrespective of the level of usage. Simultaneously, it will send customers accurate signals that encourage a higher load factor and greater system efficiency. In other words, fixed costs should be assigned to either demand or customer charges - variable costs should be assigned to energy charges only. To the extent that utilities use the equivalent peaker method, and assign portions of fixed costs to the energy charge, it contributes to the utility's revenues being more sensitive to usage changes.

Proper classification of costs as described above leads to rate design, which is beneficial for the utility and sends appropriate signals to the customers. The ICG believes that this is the most effective way of removing disincentives for utilities.

2. Question for utilities: Is your utility likely to propose energy efficiency spending above current levels if any disincentive to do so is removed?

Not Applicable.

3. If disincentives are removed and the utility elects to spend higher than current amounts on energy efficiency, is it best for (a) the utility to develop and implement the programs;(b) should that be done by Focus on Energy; (c) should it be done through a combination of the utility and Focus on Energy; or (d) should it be done through some other entity?

It is important to note that removing a disincentive does not necessarily mean that a utility will have an incentive to spend more than it currently does on energy efficiency. Similar to any other business, one way a utility maximizes its profit is by selling more of its product. But removing a perceived disincentive is not the same as providing an incentive.

ICG believes that instead of decoupling revenue from sales, it would be more effective to decouple product sales from the promotion of conservation. In other words, promote energy efficiency through an entity other than the utility such as Focus on Energy. Just as a utility's core business is to sell electricity and natural gas, this statewide organization's core business is promotion of energy efficiency. Aside from it being cost ineffective for both entities to be provide similar energy efficiency initiatives, it could also be confusing for customers and detrimentally impact the progress of market transformation.

Since the Commission administers the Focus on Energy program, this direct regulatory oversight will likely also assure that the programs being implemented are cost effective. The ICG urges the Commission to help identify ways by which the Focus on Energy program can expand offerings that will assist sophisticated energy users who have already captured the "low hanging fruit" with respect to energy efficiency and require grants to help reduce the payback.¹⁹

¹⁹ The Focus on Energy program has yardsticks for payback beyond which it is considered that customers are free riders and would implement the energy efficiency initiative without any assistance from Focus.

4. Do utilities currently have the resources to develop and implement additional energy efficiency programs?

Since it is the ICG's position that existing and additional energy efficiency programs should be offered through Focus on Energy, we believe that this question is not relevant or applicable. Instead of duplicating efforts and resources (*see* Section III above), it would be more effective and efficient to promote energy efficiency through Focus on Energy or a similar third-party, non-utility provider.

5. Should a decoupling mechanism consider only the effects of additional energy efficiency spending or should it also include the effects of other factors such as the economy and weather on actual vs. forecasted sales? If yes, please explain why.

This question presumes that a decoupling mechanism is a viable alternative. The ICG strongly opposes revenue decoupling (*see* Section IV above) and believes that there are more effective and efficient ways to address energy efficiency promotion (as highlighted in Section III above). The ICG believes that revenue decoupling is not an effective option and therefore, not viable, because:

- a. It is counterproductive to place utilities in a position that does not align with their core business generating/acquiring, selling and distributing energy.
- b. Decoupling mechanisms are focused on perceived disincentives—they do not automatically result in the promotion or capture of energy efficiency.
- c. It is difficult, if not impossible, to isolate what fraction of lower consumption may be directly attributable to energy efficiency. As highlighted in Section III above, this leads to the development of

While this is implemented with the intent to maintain the cost effectiveness of the program, it is often the case that customers especially with multiple facilities are competing for capital investment dollars and the grant funding from Focus on Energy could be responsible for approval on the remaining capital investment.

complicated methodologies that are administratively burdensome at best and in, a worst case scenario, become unmanageable.

- d. If the methodology used does not appropriately isolate the energy efficiency component of lower consumption, utilities would be unduly compensated and rates would increase unnecessarily, harming customers.
- e. Decoupling muddles pricing signals and ironically penalizes customers for being energy efficient as reflected in higher charges due to the true-up mechanism; clearly, this is an incorrect signal to send at a time when energy efficiency is a priority of Wisconsin.
- f. Rates based on costs are essential. Since decoupling involves an artificial true-up mechanism that departs from recognized, tested cost of service ratemaking principles, it will, by definition, be unjust and unreasonable to consumers including the ICG's member companies.
- g. By imposing a true-up mechanism, utilities are guaranteed their rate of return. As such, utilities will have less incentive to offer reliable service. Also, as ELCON explains, decoupling "can only promote mediocrity and indifference to the utility's core business..."

Additionally, not only does revenue decoupling negatively affect the important objectives of alignment with cost of service and sending accurate pricing to customers, it displaces the incentive for utilities to offer reliable service, a key function for any utility attempting to remove disincentives to energy efficiency. Given the compelling and significant trade offs associated with revenue decoupling, the ICG believes that such a mechanism should not be pursued further or implemented.

The Commission's question regarding the inclusion of other factors, in addition to the effects of additional energy efficiency, highlights the numerous, significant challenges associated with revenue decoupling.

First, it would be patently unjust and unreasonable to provide compensation for lost margin for factors unrelated to energy efficiency. The recovery of lost margin is meant to make the utility indifferent to lower consumption for the purpose of pursuing energy efficiency and nothing else. For example, lower consumption due to unusual weather or poor economic conditions, is unrelated to do with energy efficiency. The experience in Maine in the early 1990s is a good example of customers being forced to pay not for energy efficiency, but poor economic conditions, as explained above. Second, having a simple methodology, such as attributing any lower consumption to energy efficiency, is unfair and unreasonable. It transfers all the extraneous risk to customers and dilutes utilities' incentive to provide reliable, satisfactory and economical service. As discussed earlier, replacing a simple methodology with a complicated one creates "black box" methodologies resulting in questionable accuracy, high administrative burdens and unmanageable programs. Either way, this mechanism produces unreasonable and sub optimal results for customers.

6. If you answered yes to Question #5, should it be necessary for a utility to propose additional energy efficiency spending before it could seek recovery of any lost revenues due to other factors?

The ICG's response was "no" to Question #5.

7. If a decoupling mechanism considers only the effects of additional energy efficiency spending, but due to weather, economic or other factors, the overall sales are equal to or greater than forecast, or if due to other factors the utility is either earning its authorized ROE or is within some range of its authorized return, should it still recover the lost revenues?

The ICG believes that isolating the effects of additional energy efficiency spending may not even be viable (please see response to Question #5 regarding issues related to simple versus complex methods to isolate effects related to energy efficiency spending). Second, the ICG also believes that utilities would be incentivized to game the methods in order to prove correlation with additional energy efficiency spending. Therefore, identifying potential implications using a scenario that supposes effective isolation of energy efficiency spending is irrelevant.

8. Please provide what you believe to be the key components of a decoupling mechanism.

As discussed in response to Question #5, the ICG strongly opposes revenue decoupling mechanisms. Also, as described in Section III, overall, the ICG believes that the current regulatory framework with respect to implementing energy efficiency program is very progressive relative to the rest of the country. As such, we believe that the Commission does not need to introduce additional mechanisms, such as decoupling and performance incentives, to address real or perceived disincentives to the promotion of energy efficiency. Rather, it is the ICG's position that (a) perceived problems do not exist because of current practices, and (b) some components of the existing framework should be modified, but do not require the addition of a new layer of complexity and the potential triggering of detrimental, unintended consequences as is often the case when new mechanisms are introduced.

Components of a mechanism that can (a) remove disincentives, and (b) promote energy efficiency while maintaining Wisconsin's current regiment of sound regulatory practices that are in the public interest are:

- a. Utility obligation to perform: Continue to mandate energy efficiency promotion (*see* Section III-A. above).
- b. Leverage the core competencies of Focus on Energy or other third-party, non-utility providers that have a mission to concentrate exclusively on the promotion and capture of energy efficiency. Use the existing foundation of an independently run Focus on Energy or similar program to decouple product sales from the promotion of conservation (*see* Section III-B. and response to Question #3 above).
- c. Limit distortions and utility risk through biennial rate cases with a reopener and fuel case options (*see* Section III-C. above).
- d. Utilize the Straight Fixed Variable method to appropriately align fixed costs with demand and customer charges – and variable costs with energy charges – eliminating the consumption risk (see Section III –D)
- e. Sell “saved” MWhs in the MISO market to further eliminate risk due to lower retail consumption (*see* Section III-F above).
9. Please provide examples of ratemaking mechanisms other than decoupling that could incent utilities to pursue additional energy efficiency spending at a reasonable cost to ratepayers.

Please see response to Question #8.

10. Should all customer classes be included in any mechanism that is implemented to encourage utilities to promote additional energy efficiency spending? Why or why not?

If the Commission is implying decoupling or performance incentives, then, our response is an unambiguous “no”. As explained, member companies of the ICG are not supportive of such concepts and we do not believe that they should be imposed on the industrial customers.

However, we do not represent residential or commercial customers. If, in fact, those customers, or their representative customer organizations, want to experiment with the decoupling concept, while we think it is also not in their best interests, we would analyze and respond to such proposals on a case-by-case basis.

We support the mechanisms as identified in response to Question #8.

Aside from our firm position opposing the use of decoupling and performance incentives to promote energy efficiency, the implementation of such concepts is not practical for large industrial customers. For example, methods such as revenue per customer decoupling inherently assume an “average” customer with respect to usage/revenue. By their very nature, manufacturing processes from one industry to another are very different, as is overall usage and demand fluctuations. Unlike the residential class, it is difficult and can be misleading to characterize an “average” industrial customer. Therefore, while adding a new residential customer may not materially affect the definition of an average residential customer, the same quite likely would not hold true for an industrial customer (*e.g.*, expansion or addition of a large manufacturing plant).

11. If your answer to Question #9 is no, should additional energy efficiency programs only be designed to benefit only participating customer classes? Why or why not?

No; additional energy efficiency programs should not be designed to benefit only participating customer classes (should decoupling or performance incentive mechanisms be implemented for participating classes only). ICG members believe that such mechanisms are not effective, especially when compared to solutions we identified in our response to Question #8. It would be unreasonable to eliminate the non-participating industrial class that contributes significantly and efficiently, providing system-wide benefits through the implementation of energy efficiency initiatives. Energy efficiency programs targeted to industrials provide the “biggest bang for the buck”. Also, if the Commission were to implement our recommendations identified in response to Question #8, this would be a moot point.

12. Do you foresee controversy in determining the amount of reduced KWh sales caused by additional energy efficiency spending and the dollar margin on the reduced sales used to determine the under recovered amount to be included in rates? Why or why not?

Yes; please see response to Question #5 regarding simple versus complex methodologies associated with isolating effects of additional energy efficiency spending.

13. Considering the lag time between the design and implementation of energy efficiency programs and that utilities file regularly for rate reviews, would the following alternatives to decoupling be useful in removing disincentives to utilities promoting these programs? For programs that a utility is proposing prior to a rate case filing, an estimate of reduced sales would be made and the test year sales forecast would be reduced accordingly. For programs developed and implemented during the utility's biennial period, a decoupling mechanism could be used to adjust for the impact of these programs until the next rate case period (it would be likely that the lag time in implementing programs would make revenue adjustments relatively small).

One of the benefits of this Commission's support for utilities to file biennial rate plans, is the utilities' opportunity to regularly and frequently realign their sales forecasts and revenues. At least once every two years Wisconsin utilities update their sales forecast

data—and may do so once every year. As a consequence, they should be able to encourage energy efficiency with greatly tempered concern and uncertainty as to how energy efficiency will reduce their sales.

Utilities' risks are further reduced by the higher than industry-average returns on equity that this Commission has consistently authorized over the past years. For the most recent year for which the information is available--September 2006 through August 2007--of the reported 57 state public utility commission decisions for which authorized returns were addressed in those decision, all but five (46) had returns lower than those returns authorized by this Commission. *See* "Annual ROE Survey, Capitalizing on Grid Concerns", Public Utilities Fortnightly, November 2007, pp. 43-46. Wisconsin's high rates of returns will compensate the utilities for any perceived risk that flows from sales uncertainties.

Overall, the current ratemaking practice maintains regulatory oversight to protect customers while providing mechanisms whereby utilities can regularly update their sales forecast and request revised cost recovery to protect their bottom line and mitigate risk for their investors. Consequently, in Wisconsin practice there is little room for distortions because of the frequent rate case applications. Therefore, the ICG believes that no adjustments are needed.

14. Is revenue decoupling illegal retroactive ratemaking? Why or why not?

Although ICG does not support decoupling, it also doesn't believe that it constitutes retroactive ratemaking, for a couple of reasons. First, under the decoupling mechanisms that have been presented in rate cases by Wisconsin utilities most recently, rates are set in advance, subject to true up. This differs little from the manner in which the Fuel Rules, to take one example, work.

15. Are you aware of mechanisms other states use to incent additional energy efficiency on behalf of their utilities that you believe would be successful in Wisconsin? If so, please identify these states.

ELCON points to Wisconsin, as well as New York and Vermont, as states that have used an independent entity whose sole mission is to promote energy efficiency.²⁰ The ICG believes that this approach would be successful in promoting greater energy efficiency in Wisconsin especially since the framework already exists.

16. Does a decoupling mechanism represent a reduction in risk to the utility? If so, should that be reflected in the authorized return on equity?

A decoupling mechanism significantly reduces risk for a utility by protecting against lost revenues. Investors will be over compensated if authorized rates of return are not lowered to reflect this lower usage. Therefore, the risk reduction must be reflected in the authorized return to equity. The ICG has some concern, though, that it will be difficult if not impossible to tie directly a reduction in a utility's rate of return to the adoption of a decoupling mechanism because so many different elements must be considered in determining a utility's risk profile.

17. What process should the Commission use to establish the parameters of ratemaking approaches that promote energy efficiency, i.e., should the Commission approve utility-specific plans or establish guidelines for implementation in rate cases?

To the extent that the Commission uses the ICG's recommendation to utilize the Focus on Energy "umbrella" for all energy efficiency programs, it would be beneficial to develop the parameters using stakeholder input through a docket investigation.

Should the Commission decide to use other mechanisms, it should approve utility specific plans. Each utility has different methods of cost allocation in their cost

²⁰ ELCON Brief on Decoupling.

of service studies and varying inter- and intra-class rate designs. The parameters that the Commission seeks to establish will most likely be affected by these factors.

18. Are there important differences between gas and electric utilities to be considered when designing an incentive mechanism?

From ICG's perspective, our recommended approach of using the Focus on Energy umbrella would apply for natural gas and electric utilities.

The ICG's recommended approach to use the Focus on Energy "umbrella" applies for natural gas and electric utilities.

With respect to any other incentive mechanisms, there appears to be more momentum in experimenting and adoption of mechanisms in the natural gas industry. This may be attributed to the fact that natural gas utilities for the most part have volumetric rates and so may face a large risk with respect to lost revenues. In Wisconsin, some utilities, such as Wisconsin Public Service Corporation, use the straight fixed variable design for industrials. Similar to electric, such a rate design will eliminate the lost margin risk associated with lowering sales – at least from industrials. The ICG encourages the application of this method as recommended for electric utilities as well.

VI. CONCLUSION.

The ICG thanks the Commission again for providing stakeholders the opportunity to comment in this important investigation. If this response generates any questions, or requires greater clarification, it will be pleased to respond accordingly.

Dated: July 22, 2008

Midwest Food Processors Association

By: /s/

Nick George
4600 American Parkway, Suite 110
Madison, WI 53718-8334
(608) 255-9946
nick.george@mwfpa.org

Wisconsin Industrial Energy Group, Inc.

By: /s/

Todd Stuart, Executive Director
10 East Doty Street, Suite 800
Madison, WI 53703
608-441-5740
tstuart@wieg.org

Wisconsin Paper Council

By: /s/

Earl Gustafson, VP – Energy Forestry & HR
250 North Green Bay Road (54956)
P.O. Box 718
Neenah, Wisconsin 54957-0718
920-722-1500
gustafson@wipapercouncil.org

KM Energy Consulting, LLC

By: /s/

Kavita Maini
961 North Lost Woods Road
Oconomowoc, WI 53066
262-646-3981
kmaini@wi.rr.com